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No. 97-1732

IN THE
Supreme Court of the United States
OCTOBER TERM, 1997

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM and FLORIDA STATE BOARD OF ADMINISTRATION,
Petitioners,

v.

PAUL FELZEN, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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PETITIONERS' REPLY BRIEF

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PETITIONERS' REPLY BRIEF

Respondents in opposition [1] do not dispute the Seventh Circuit's conclusion that the lower "[c]ourts have disagreed for several decades" about whether nonparty shareholders "must intervene as parties in order to appeal." Pet. App. at 2a. They do not offer any means of reconciling this split of authority. They do not attempt to respond to petitioners' argument that the Seventh Circuit's decision

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[1] Only the two individual plaintiffs in this derivative action, whose attorneys are currently slated to receive a substantial portion of the settlement's proceeds, chose to file an opposition to petitioners' certiorari petition. Brief for Respondents in Opposition ("BIO") at 1. Archer Daniels Midland Company and the individual director defendants, though parties to the derivative settlement, have waived opposition. Certain other attorneys for plaintiffs below who themselves opposed the fee amounts granted to counsel for respondents also have waived opposition.

was based on a misreading of *Marino v. Ortiz*, 484 U.S. 301 (1988), and Federal Rule of Appellate Procedure 3(c). Pet. at 17-23.[2] Nor do they rebut petitioners' substantial showing that the Seventh Circuit's new rule imposes a substantial burden on shareholders who seek to contest improper or inadequate derivative suit settlements.[3]

Respondents likewise do not (and cannot) dispute that the court of appeals created a second, independent circuit split with the Ninth Circuit over whether new jurisdictional rules must always be applied retroactively. Pet. App. at 10a (conceding "disagreement" with *George v. Camacho*, 119 F.3d 1393 (9th Cir. 1997)). They do not dispute that the Seventh Circuit's position in this split undercuts the judiciary's interest in promoting reliance on settled law and will have the effect of barring the appeals of an entire class of litigants. Pet. at 25-26. And, again, they do not even purport to defend the merits of the Seventh Circuit's position in this split. *Id.* at 26-30.

1. Instead, respondents spend much of their opposition arguing that, in an opinion issued six weeks before the Rule 23.1 hearing in this case, *In re Brand Name Prescription Drugs Antitrust Litigation*, 115 F.3d 456 (7th Cir. 1997), the Seventh Circuit "removed any doubt" that shareholders must intervene to appeal. BIO at 6. But

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[2] Respondents characterize petitioners as representing "less than one percent of the Company's shareholders." BIO at 2. Their combined 4.6 million shares, however, currently represent an investment of nearly $90 million, making them among the largest shareholders of Archer Daniels Midland Company, which respondents themselves elsewhere admit. *Id.* at 1, n.1.

[3] Respondents suggest that "petitioners' counsel admitted . . . that he had no evidence of any collusion" in this case. BIO at 15, n.10. But, on the contrary, the sole page of the record respondents cite shows petitioners' counsel arguing that "[w]here there is a cash settlement and a large percentage of the cash is earmarked for lawyers, that by itself raises an inference of collusion. * * * In fact, their opening commentator, Mr. Coffee says as much in some of his law review work." BIO App. at 2.

even if this procedural history were accurate, it would only underscore the need for certiorari by confirming that the issue presented recurs regularly and the Seventh Circuit is unlikely to reverse course and resolve its split with the Third and Tenth Circuits on its own accord.

In any event, respondents' procedural history is at odds with the Seventh Circuit's own explanation. Judge Easterbrook himself described *In re Brand Name* as holding only that "a class member in an action under Fed. R. Civ. P. 23 who has not become a party may not appeal from an order granting summary judgment." Pet. App. at 2a. Nothing in Judge Easterbrook's opinion, or *In re Brand Name* itself, even remotely suggests that decision also mandated intervention for shareholders seeking to appeal derivative settlements. Indeed, had the panel in *In re Brand Name* decided that nonparty shareholders must intervene, it would have been required to overrule the Seventh Circuit's prior contrary decision in *Tryforos v. Icarian Dev. Co.*, 518 F.2d 1258 (7th Cir. 1975) (Stevens, J.), *cert. denied*, 423 U.S. 1091 (1976), and to circulate its opinion among the entire circuit or seek an *en banc* hearing. The panel in this case could not have declared that *it* was "overrul[ing] *Tryforos* to the extent it permits non-party shareholders to appeal in actions under Rule 23.1." Pet. App. at 6a-7a. It would have had no reason to indicate that *this* decision creates a conflict with the Third Circuit's decision in *Bell Atlantic*. *Id.* at 7a. It would have had no need to devote several pages of its opinion to the question whether "to defer the effect" (*id.*) of its "new precedent" (*id.* at 7a-8a). And it would have had no need to circulate its opinion among the entire court of appeals for review on the grounds that it "overrules some of our decisions." *Id.* at 10a.

Ultimately, respondents can criticize petitioners only for failing to *predict* the Seventh Circuit's decision here.[4] But

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[4] In a footnote, respondents question whether petitioners even relied on *Tryforos*. BIO at 7, n.4. But petitioners expressly did

failing to guess that a court of appeals might reverse its own longstanding precedent and create a circuit split is hardly grounds for denying certiorari. Nor was the Seventh Circuit's result so easy to foresee. When petitioners filed their appeal in this case, nonparty shareholder appeals had been expressly endorsed by the Third Circuit only four years earlier, *Bell Atlantic Corp. v. Bolger*, 2 F.3d 1304 (3d Cir. 1993), and uniformly praised by recognized authorities on civil procedure.[5] The panel in *In re Brand Name*, moreover, barred Rule 23 nonparty appeals only of summary judgment orders. It nowhere revealed any intent to reverse a prior panel decision—just five years old—that expressly reaffirmed the right of Rule 23 class members to appeal settlement decisions. *VMS Ltd. Partnership Sec. Litig.*, 976 F.2d 362, 367, 368 n.8 (7th Cir. 1992) ("*Research Corp.* still controls [the] issue," permitting standing for "an unnamed class member who appeals the approval of a consent decree").[6]

2. Judge Easterbrook went out of his way to highlight for this Court the Seventh Circuit's "disagree[ment] with

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so in their brief to the court of appeals, as the Seventh Circuit acknowledged. Pet. App. at 2a-3a ("two shareholders who have appealed from the district court's approval of a settlement in this derivative action ask us to apply *Tryforos*"). The court of appeals even considered whether it could "defer the effect" (*id.* at 7a) of its reversal of *Tryforos* out of equity to petitioners, concluding only that it was powerless to do so (*id.* at 7a-10a).

[5] *See, e.g.*, 3B James W. Moore, Moore's Federal Practice, ¶ 23.1.24[3] (1993) (objector's right to appeal derivative suit settlement); *id.* ¶ 23.80[5] (1993) ("[a] member of the class who appears in response to the court's notice . . . and objects to the dismissal or compromise has a right to appeal from an adverse final judgment although he did not become a formal party of record"); 7C Charles A. Wright, *et al.*, Federal Practice and Procedure § 1839, at 182 (2d ed. 1986) ("[a]n objector to the settlement may appeal the court's approval of the compromise").

[6] Even *In re Brand Name*'s limited holding in the Rule 23 context was far from stable: at the time petitioners entered this case, *In re Brand Name* was subject to a motion for reconsideration and was later amended twice by the court of appeals.

the conclusion of [the Third Circuit in] *Bell Atlantic*" (Pet. App. at 7a). Respondents do not dispute the existence of this split, but nonetheless claim the Court should deny certiorari because the Seventh Circuit's position "is plainly correct and is supported by a well-reasoned opinion." BIO at 9. Yet, one of the primary functions of this Court's certiorari jurisdiction is to resolve circuit splits over questions of federal law; whether the reasoning of the Seventh Circuit or that of the Third (and Tenth) Circuits ultimately proves persuasive is immaterial. Petitioners have, moreover, already amply demonstrated that the Seventh Circuit's decision is based upon flawed interpretations of *Marino* and Federal Rule of Appellate Procedure 3(c). Pet. at 17-23. Tellingly, respondents do not even *attempt* to confront this analysis in their opposition. *See* BIO at 9.

Instead, respondents claim that circuit splits over "procedural rules that ultimately affect a court's jurisdiction" are not worthy of this Court's review because litigants can simply "adjust their conduct" to comply with any circuit's particular view. BIO at 10. But this Court has few duties more important than ensuring consistency in the administration of justice in the federal courts. Permitting open disputes over the federal rules to linger without resolution simply because they are "procedural" invites balkanization of the federal judiciary, undermines the judiciary's interest in promoting reliance on uniform procedures, and allows lower courts to disregard with impunity policies set and approved by this Court and Congress. Unsurprisingly, respondents can cite no authority for the rule of review they posit, nor can they explain the innumerable cases in which the Court *has* reviewed disagreements over the proper interpretation of "procedural" rules.[7]

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[7] *See, e.g., Henderson v. United States*, 517 U.S. 654, 660 (1996) (Court "granted certiorari to resolve disagreement among lower courts on the question whether Federal Rule 4, which authorizes an extendable 120-day period for service of process, supersedes the Suits in Admiralty Act provision that service on the United States

Besides, the very fact that nonparty shareholders will have to "adjust their conduct" to comply with the Seventh Circuit's new rule *favors* certiorari. Courts and commentators have long recognized the tendency of derivative litigation to lose its adversarial character and result in collusive deals between the company and plaintiffs' lawyers; for just as long, Rule 23.1 and the courts have encouraged unfettered shareholder participation as the key safeguard against such collusion. *See* Pet. at 14, nn.14 & 15. Requiring shareholders to "adjust their conduct" by filing motions to intervene imposes new costs and burdens (and thus decreases the likelihood) of their participation. *Id.* at 10, 14-17. Indeed, the Third Circuit expressly refused to require intervention motions for precisely these reasons. *Bell Atlantic*, 2 F.3d at 1310 (Rule 23.1's goal of preventing collusive settlements "cautions against creating obstacles to challenging derivative action settlement agreements"). *See also Gottlieb v. Wiles*, 11 F.3d 1004, 1010-11 (10th Cir. 1993);[8] Timothy A. Duffy, Note, *The Appealability of Class Action Settlements by Unnamed Parties*, 60 U. Chi. L. Rev. 933, 951 (1993) ("Duffy") (intervention inconsistent with "encourag[ing] fair settlements").

Even those shareholders who are not deterred by the additional burden associated with seeking intervention will, moreover, almost assuredly be denied leave to participate. Under Rule 23.1, shareholders are typically notified

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be made 'forthwith' "); *Carlisle v. United States*, 517 U.S. 416 (1996) (certiorari granted to determine whether trial court has authority under Fed. R. Crim. P. 29(c) to grant motion for acquittal even if it is untimely under that rule); *Celotex Corp. v. Edwards*, 511 U.S. 1105 (1994) (granting certiorari to resolve meaning of Fed. R. Civ. P. 65.1); *Pavelic & LeFlore v. Marvel Entertainment Group*, 493 U.S. 120, 122-23 (1989) (certiorari granted to resolve circuit split over interpretation of Fed. R. Civ. P. 11).

[8] Contrary to respondents' assertions, *Gottlieb* discussed *Bell Atlantic* approvingly and at length. *Id.*

of their right to participate only *after* the parties tentatively reach a settlement, and existing federal law strongly disfavors permitting intervention after a tentative settlement is reached. Pet. at 16 & n.18. Thus, no matter how shareholders may try to "adjust their conduct," the Seventh Circuit's rule will insulate flawed derivative settlements from any appellate scrutiny.[9] Finally, even if shareholders could somehow succeed in intervening, they would face all the duties associated with becoming a party, including duties to comply with automatic disclosure requirements, appear for depositions, answer interrogatories, and produce documents—plainly substantial deterrence to encouraging maximum shareholder participation. Pet. at 15-16.[10]

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[9] Respondents also cannot dispute that denials of motions to intervene are virtually unreviewable on appeal. Pet. at 13-14 & n.13. Indeed, some courts of appeals have even suggested that objecting shareholders' interests are always already adequately protected by party shareholders in Rule 23.1 proceedings. *See, e.g., id.; In re General Tire & Rubber Co. Sec. Litig.*, 726 F.2d 1075, 1087 (6th Cir.), *cert. denied*, 469 U.S. 858 (1984).

[10] Respondents argue that courts may permit shareholders to intervene "solely for the limited purpose of appeal." BIO at 14, n.9. But this assertion is wholly speculative: there is no federal rule shielding intervening parties from the ordinary duties of parties, and no certainty that the lower courts would manufacture such a rule. In fact, in their very next breath respondents argue *against* granting any such special protections. BIO at 14 (claiming it is "unfair to allow this individual shareholder to 'hold up' " the case without assuming "some responsibility").

The burdens associated with an intervention requirement are illustrated by the facts of this case. On May 30, 1997, the trial court tentatively approved the settlement. Only then were shareholders notified by mail of their right to participate (making it presumptively too late to intervene under federal law, *see* Pet. at 16, n.18). They were given just one month, until July 3, 1997, to review the parties' settlement, hire counsel, prepare and submit their objections, and appear before the court. The Seventh Circuit's rule would require shareholders also to prepare and argue a motion to intervene in this same limited amount of time.

3. Instead of defending the Seventh Circuit's express reliance on *Marino* and Federal Rule of Appellate Procedure 3(c) against petitioners' analysis, respondents suggest that the Seventh Circuit's decision is "sound" on an alternative ground. BIO at 12. Permitting individual shareholder appeals would, they argue, unduly " 'fragment' " and " 'confuse[]' " derivative suits. *Id.* But this argument, too, only underscores the depth of the disagreement between respondents and courts who believe it is imperative to avoid "creating obstacles" to shareholders' ability to participate in the appellate process as counterweight to the parties' natural tendency to collude. *Bell Atlantic*, 2 F.3d at 1310. *See also Gottlieb*, 11 F.3d at 1010-11; Duffy, 60 U. Chi. L. Rev. at 951. Besides, respondents lack any factual support for their empirical claim: courts, including the Seventh Circuit, have for decades permitted nonparty shareholder appeals without incident. And if allowing individual shareholder appeals *did* somehow create too much confusion, the appropriate remedy would not be to make parties out of individual shareholders but to preclude them from appeal altogether.

Respondents suggest that the Seventh Circuit's decision logically follows the fact that the nonparty shareholders have "no individual right to sue." BIO at 12-13. At best, however, this is another controversial view not shared by the Third Circuit (or apparently the Tenth Circuit and those commentators who approve of *Bell Atlantic*'s holding), and thus another reason favoring certiorari. Besides, while shareholders may not sue in their own names for damage done to the corporation, neither respondents nor the Seventh Circuit suggest that nonparty shareholders lack sufficient injury under Article III or 28 U.S.C. § 1291 to appeal a derivative settlement; to the contrary, the Seventh Circuit expressly recognizes that nonparty shareholders do have standing and criticizes the Third Circuit for conceiving of the issue simply as a standing question. Pet. App. at 7a.[11] Moreover, if any logical presumption follows, it is that a shareholder expressly allowed to object in the trial court under Rule 23.1 should be permitted to contest the disposition of its objections in the court of appeals. Indeed, the courts of appeals have routinely permitted appeals by an array of injured nonparties, and there is no reason to treat objecting shareholders any differently. Pet. at 20-21.[12]

[11] "Standing means injury in fact, and a reduction in the market price of one's stock is injury. Parties are a subset of injured persons. Equating injury with party status is exactly the approach disapproved by *Marino*." *Id.*

4. After "overrul[ing] *Tryforos*," the Seventh Circuit turned to consider whether, out of equity to petitioners, it should "defer the effect" of its ruling and apply its decision only prospectively. Pet. App. at 7a. The court, however, ultimately concluded that it was powerless to apply any new rule "concern[ing] jurisdiction" only prospectively, expressly acknowledging its "disagree[ment]" on this legal question with *George*. Pet. App. at 10a.

Respondents argue against granting certiorari on this second circuit split on the ground that no new rule was announced below. BIO at 15. But this argument (again) requires the Court to ignore the Seventh Circuit's own description of its holding both in this case and in *In re Brand Name*. *See* pp. 3-4, *supra*. Respondents fleetingly assert that, in any event, the Seventh Circuit's disagreement with the Ninth Circuit rises only to the level of "dictum." BIO at 15. But they never explain or defend this point. And here, too, they are at odds with the Seventh Circuit, which acknowledged that its disagreement

[12] Respondents discount petitioners' argument that leaving this split unresolved encourages forum shopping as "nonsensical and insulting to the federal judiciary." *Compare* Pet. at 17 *with* BIO at 11. In fact, however, the possibility of filing in a jurisdiction where any settlement is virtually guaranteed no appellate scrutiny would surely be an incentive to the plaintiffs' bar. And it is hardly insulting to the federal judiciary to suggest that improper settlements may evade judicial detection without the benefit of adversarial scrutiny that nonparty shareholder participation provides. Indeed, the Third Circuit has itself expressly worried about just this possibility. *Bell Atlantic*, 2 F.3d at 1310.

with the Ninth Circuit's decision in *George* is both genuine and pronounced. Pet. App. at 10a; *see also* Pet. at 24-25 (unrefuted explanation of split).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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